RECORD AND BRIEFS

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In the Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,
Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF *AMICI CURIAE* STATES OF ILLINOIS, ALASKA, ARIZONA, GEORGIA, HAWAII, LOUISIANA, MAINE, MONTANA, NEW HAMPSHIRE, NEW YORK, OHIO, OREGON, PENNSYLVANIA, RHODE ISLAND, TENNESSEE, TEXAS, UTAH, WASHINGTON, AND WEST VIRGINIA IN SUPPORT OF PETITION FOR CERTIORARI

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QUESTION PRESENTED

Whether a bankruptcy court can authorize a settlement that provides for dismissal of the bankruptcy case and distribution of settlement proceeds in a manner that is inconsistent with the Bankruptcy Code's priority scheme?

TABLE OF CONTENTS

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

INTEREST OF *AMICI CURIAE* 1

STATEMENT OF CASE 3

REASONS FOR GRANTING THE PETITION 8

I. THE FEDERAL COURTS OF APPEAL ARE DIVIDED OVER THE VALIDITY OF PRIORITY-SKIPPING SETTLEMENTS AND STRUCTURED DISMISSALS 8

II. THE THIRD CIRCUIT'S DECISION THREATENS TO UNDERMINE THE PRIORITIES CONGRESS ESTABLISHED IN THE BANKRUPTCY CODE, MANY OF WHICH PROTECT IMPORTANT STATE INTERESTS 12

CONCLUSION 17

TABLE OF AUTHORITIES

Page

Cases

Bull v. U.S., 295 U.S. 247 (1935) 12

Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33 (2008) 14

In re AWECO, Inc., 725 F.2d 293 (5th Cir. 1984) 8, 9, 10

In re ICL Holding Co., 802 F.3d 547 (3d Cir. 2015) 13

In re Iridium Operating LLC, 478 F.3d 452 (2d Cir. 2007) 10, 11

In re Longo, 144 B.R. 305 (Bankr. D. Md. 1992) 2

Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc v. Anderson, 390 U.S. 414 (1968) 9

Statutes and Regulations:

11 U.S.C. § 101 *et seq* 1

11 U.S.C. § 362(b)(9)(D) 12

11 U.S.C. § 362(b)(18) 12

11 U.S.C. § 503(b)(1)(B) 12

11 U.S.C. §507 1

11 U.S.C. § 507(a)(1) 1, 12

11 U.S.C. § 507(a)(4) 1, 4

11 U.S.C. § 507(a)(7) 2

11 U.S.C. § 507(a)(8) 1, 12

11 U.S.C. §523(a)(1) 12

11 U.S.C. § 724(b) 12

11 U.S.C. § 1123(a)(1) 13

11 U.S.C. §1129 9

11 U.S.C. §1129(a)(7) 13

11 U.S.C. §1129(a)(8) 13

11 U.S.C. §1129(a)(9)(C) 13

11 U.S.C. § 1129(b)(1) 9

11 U.S.C. § 1146(a) 14

29 U.S.C. §§ 2101–2109 3

Illinois Equal Pay Act of 2003,
820 ILCS 112/1 *et seq* 2

Illinois Minimum Wage Act,
820 ILCS 105/1 *et seq* 2

Millville Dallas Airmotive Plant Job
Loss Notification Act,
N.J. Stat. Ann. Sections 34:21 1 to 7 4

New York Worker Adjustment
and Retraining Notification Act,
New York Labor Law, § 860 *et seq.* 2

Wash. Rev. Code § 49.46.090 3

Wash. Rev. Code § 49.48.030 3

Rules:

Fed. R. Bankr. P. 9019 ..... 6, 8

INTEREST OF *AMICI CURIAE*[1]

This case presents the question of whether some of the parties to a bankruptcy case may agree to settle the distribution of estate assets outside the established priority system of the Bankruptcy Code (the "Code"), *see* 11 U.S.C. § 507, as a prelude to dismissal of the case. Here, the lower courts approved a settlement that directed assets to certain creditors while excluding other creditors who had higher priority under the Code. Allowing such settlements undermines the Code's creditor priorities and creates an extra-statutory process that parties can use to avoid the requirements of either a Chapter 11 plan or a Chapter 7 liquidation.

The Amici States are deeply concerned about the ramifications of this approach because they are entitled to assert priority status under the Code for, *inter alia*, their taxes, *see* Section 507(a)(8),[2] as well as other types of claims that they can assert either directly or on behalf of their citizens. For example, Section 507(a)(1) provides a first priority to claims for domestic support obligations whether asserted by individuals or governmental units. Section 507(a)(4) provides a priority for pre-petition wages, and many States, under numerous statutes including minimum wage laws, equal pay acts and state worker adjustment and retraining notification acts (WARN Acts) have the power to assert claims on behalf of work-

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[1] The parties received timely notice of amici's intent to file this brief.

[2] All references to "Sections" in this brief are to sections of the Code, 11 U.S.C. § 101 *et seq.*

ers.[3] And Section 507(a)(7) grants a priority to consumer deposits that can be enforced by governmental entities. *See In re Longo*, 144 B.R. 305, 308 (Bankr. D. Md. 1992) (holding that Maryland Higher Education Commission could assert valid claims on behalf of students for tuition refunds under consumer deposit priority). The other parties in the case, however, will be unlikely to respect those priorities if they are able to devise their own *ad hoc* priorities. To the contrary, trade creditors, secured lenders, potential buyers, and the debtor will likely view such payments as detracting from assets to which they might otherwise have access. Thus, if parties are able to agree on a distribution of the debtor's assets in a way they prefer, rather than according to the Code's priority scheme, claims under taxing and other priorities are likely to be downgraded despite their statutory protections.

The States submit that even in those situations where a structured dismissal is appropriate, distributing the assets of the estate in compliance with the statutory priorities should be mandatory. The Third Circuit's decision in this case, on the other hand,

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[3] *See, e.g.*, Illinois Minimum Wage Act, 820 ILCS 105/1 *et seq.* (under § 12, the Director can enforce minimum wage claims for employees), Illinois Equal Pay Act of 2003, 820 ILCS 112/1 *et seq.* (under § 30, the Director can enforce claims of individuals); New York Worker Adjustment and Retraining Notification Act, New York Labor Law, § 860 *et seq.* (under § 860-f, the Commissioner has power to collect on behalf of employees); Wash. Rev. Code § 49.46.090 (authorizing Director of Washington Department of Labor and Industries to take legal action on behalf of employees for wages owed); Wash. Rev. Code § 49.48.030 (authorizing Department to investigate claims of unpaid wages and order payment of wages owed).

ignores both plain statutory language and congressional intent and threatens States' ability to protect their interests in bankruptcy court.

STATEMENT OF THE CASE

The factual issues in this case are neither complex nor disputed. A subsidiary of Sun Capital Partners ("Sun"), a private equity firm, bought the Debtor, Jevic Transportation, Inc. ("Jevic"), a trucking company, in a leveraged buyout in 2006 through a transaction that involved using Jevic's own assets to finance the purchase price. App. 2a. Shortly afterwards, Jevic refinanced this new debt with a loan from CIT Group/Business Credit, Inc. ("CIT"), and it granted CIT a first lien on all of its assets. App. 2a, 36a. Jevic already was in financial distress when it was acquired; by 2007, it was no longer able to service the new debt and was in default on the loan from CIT. App. 2a. Jevic signed a forbearance with CIT in early 2008 that resulted in its new owner, Sun, agreeing to guarantee $2 million of the CIT loan. *Id.*

Jevic was unable to maintain compliance with the terms of that forbearance, and it expired in early May 2008; on May 19, Jevic notified its employees that the company was closing and that they would be laid off shortly. *Id.* It filed its bankruptcy petition on May 20, 2008. App. 3a.

Nearly 1,800 Jevic truck drivers who were laid off without warning filed a class action suit in the bankruptcy court under the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C. §§ 2101–2109 (the "WARN Act") and a similar state

WARN Act in New Jersey, the Millville Dallas Airmotive Plant Job Loss Notification Act, N.J. Stat. Ann. Sections 34:21-1 to -7, both of which require notice to employees before plant closings or mass layoffs. The employees sued both Jevic and Sun, alleging that Sun was a joint employer with Jevic and so could be held jointly liable for the violations. App. 3a, 37a. The employees estimated that their claim was worth $12.4 million, of which $8.3 million was assertedly a priority claim under Section 507(a)(4). App. 5a–6a.

Separately, the Unsecured Creditors' Committee (the "Committee") was given authority by the bankruptcy court to bring suit in that court against Sun and CIT on the estate's behalf, based on a claim that the leveraged buyout was a fraudulent transfer that had saddled Jevic with debts it could not possibly expect to pay and thus hastened its financial collapse. App. 3a. That complaint survived a motion to dismiss with respect to its counts for fraudulent and preferential transfers, and the Committee filed an amended complaint with respect to the counts that were dismissed. App. 3a–4a, CAJA 764. The remedy sought in the complaint was the avoidance of all liens held by CIT and Sun and the recovery of all buyout-related transfers from Jevic to CIT and Sun made as part of the buyout. App. 54a. The total amount of those transfers exceeded $100 million, well in excess of the approximately $20 million owed to creditors other than CIT and Sun. CAJA 770–772, App. 3a.

By the end of 2011, however, the estate's assets had dwindled to the Committee's causes of action against CIT and Sun and about $1.7 million in

cash, which was subject to Sun's lien (although the lien was disputed). App. 4a. There were a number of outstanding administrative expenses that could not be satisfied in light of Sun's *prima facie* lien on the available cash. App. 4a–5a. And although discovery had been proceeding for some time, the WARN Act litigation was still unresolved. App. 5a–6a.

Accordingly, in early 2012, all parties—Jevic, Sun, CIT, the Committee, and the employees—sought to negotiate a global resolution of the case. App. 4a. In the end, an agreement was reached by all parties except the employees. The agreement provided that: (a) Jevic, Sun, CIT, and the Committee would release each other, and the fraudulent conveyance action would be dismissed with prejudice; (b) CIT would contribute $2 million that would be used to pay some of Jevic's administrative expenses and the Committee's legal expenses; (c) Sun would release its lien on the $1.7 million in cash and those funds would be used to pay Jevic's remaining administrative expenses and the tax claims, as well as about 4% to general unsecured creditors;[4] and (d) Jevic's bankruptcy case would then be dismissed. App. 5a. The claims of the employees were left out of the settlement entirely even though some were priority claims. App. 5a–6a. Sun's counsel conceded in the bankruptcy court hearing that the settlement was structured to ensure that the employees would not

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[4] The original version of the settlement would have devoted the entire $1.7 million to the general unsecured creditors, but after objections from the United States Trustee, priority tax creditors, and the employees, that aspect of the settlement was revised to ensure that the administrative and priority tax claims were paid. App. 3a, n.1.

receive any estate funds that could be used to help continue their pending WARN Act litigation against Sun.[5] App. 6a–7a, n. 4

The bankruptcy court, the district court, and the panel majority in the Third Circuit all concluded that the settlement should be approved, even though it concededly did not follow the priority rules that would have been applicable if the Debtor had sought to confirm a plan in Chapter 11 or if it had converted its case to a Chapter 7 liquidation. App. 53a–61a, 42a, 23a. In its decision, the Third Circuit first concluded that where there was no prospect of a confirmed plan and where conversion to chapter 7 was unrealistic, a bankruptcy court can enter a structured dismissal order provided it was not entered to evade the protections and safeguards of plan confirmation or conversion to chapter 7. App. 12a–15a. It further concluded that because nothing in the Code explicitly requires that a settlement agreement satisfy the Code's priority requirements, a settlement need only meet the requirement in Federal Rule of Bankruptcy Procedure 9019 that it be "fair and equitable," App. 11a, and that a priority-skipping settlement could meet that standard, App. 21a. Although it asserted that such a result would be "justified only rarely," it found the settlement acceptable

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[5] After the settlement, the bankruptcy court entered summary judgment in May 2013, against Jevic on the undisputed state WARN ACT claim. App. 5a–6a, n.2. At the same time, it rejected the allegation that Sun was a joint employer with Jevic and dismissed the litigation with respect to Sun. *Id.* Due to the settlement, the finding that Jevic was liable did not result in any payment to the employees.

because it was the "least bad alternative," in that it provided payment to a number of creditors, not just the secured lenders, even if it did so at the expense of higher priority creditors who were entitled to be paid ahead of the general unsecured creditors. App. 21a.

Judge Scirica dissented. *Id.* He explained that a party such as Sun should not be able to dictate the structure of distribution of the estate and that the actions of the settling parties here did nothing to maximize estate assets, but rather served only to direct them to preferred creditors. App. 25a–26a. The dissent also warned that this decision would become a template for parties in future cases to shape estate distributions for their individual benefit rather than in accordance with the Code's priorities. App. 31a. After noting the high level of secured debt owed by many debtors currently filing for chapter 11, he stated, "It is not difficult to imagine another secured creditor who wants to avoid providing funds to priority unsecured creditors, particularly where the secured creditor is also the debtor's ultimate parent and may have obligations to the debtor's employees." *Id.* Thus, Judge Scirica concluded "approval of the bankruptcy court's ruling in this case would appear to undermine the general prohibition on settlements that deviate from the Code's priority scheme." *Id.*

REASONS FOR GRANTING THE PETITION

I. The Federal Courts of Appeal Are Divided Over the Validity of Priority-Skipping Settlements and Structured Dismissals.

There is now at least a three-way split among the circuit courts with respect to whether a settlement that results in the payment of estate funds may avoid the priority requirements of the Bankruptcy Code and if so, under what circumstances. That confusion leaves all parties without the necessary clarity as to the legal framework applicable to their efforts to resolve disputes. It also allows parties with leverage in a case to use that power to enhance their own position while disregarding the priorities Congress chose when it drafted the Code, and it invites forum-shopping.

Petitioner's brief describes the overall structure of the Code and the exit options it provides to debtors: (a) confirming a plan under Chapter 11 (which may be a reorganization or a liquidation), (b) converting the case to a Chapter 7 liquidation, (c) or dismissing the case. In addition, settlements may be approved under Rule 9019, which has no explicit substantive standards for that approval. The issue here is what limits should be imposed on a settlement regarding estate assets, particularly when the settlement becomes the basis for the distribution of the entire estate and the subsequent dismissal of the case. The circuit split on these issues needs to be resolved by this Court.

The Fifth Circuit has expressly rejected the view that pre-confirmation settlements are exempt from the priority structure of the Code. In *In re*

AWECO, Inc., 725 F.2d 293 (5th Cir. 1984), it reversed a lower court decision approving a settlement that would have paid general estate funds to an unsecured creditor where it was not clear that doing so would leave sufficient funds to ensure payment of the priority tax claim held by the IRS. The Fifth Circuit relied on *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc v. Anderson*, 390 U.S. 414 (1968), which held that a settlement, entered into as part of a Chapter 11 plan, was subject to the overall requirement that the plan be "fair and equitable," *see* 11 U.S.C. § 1129(b)(1), and that those words were a "term of art" that specifically incorporated the absolute priority standard. *AWECO*, 725 F.2d at 298.

Although *TMT* discussed this standard only in connection with a settlement as part of a plan, and the Fifth Circuit in *AWECO* concluded that the Section 1129 requirement of "fair and equitable" treatment does not literally apply to pre-plan settlements, that court held that "[a]s soon as a debtor files a petition for relief, fair and equitable settlement of creditors' claims becomes a goal of the proceedings. The goal does not suddenly appear during the process of approving a plan of compromise." *Id.*

Thus, the court held, it was obligated to review all settlements, not only as to whether they would be fair as between the parties who negotiated them, but also as to how they would affect all others in the case. Even pre-plan settlements must meet the fair and equitable standard, and "a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that

priority of payment will be respected as to objecting senior creditors." *Id.*

The Second Circuit has taken an intermediate position, rejecting a *per se* rule against *any* violation of the absolute priority rule but strongly cautioning against allowing such deviations. In *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007), the bankruptcy court approved a settlement of a suit brought by the Creditors Committee against a secured lender. Some proceeds from that settlement would be used to fund a trust that would pursue litigation on behalf of the estate against an entity (Motorola) that had asserted its own priority claims in the case. Those settlement funds, thus, were not paid directly to any creditors but, instead, were retained in the estate to pay expenses of the Motorola litigation. *Id.* at 459. Any amount left in the litigation trust after the Motorola suit was concluded would be paid to the general unsecured creditors instead of being returned to the estate for allocation under the normal priority provisions. *Id.* The Second Circuit approved the first aspect of the settlement (which did not entail any priority skipping) but remanded the second aspect for further analysis and justification. *Id.* at 466. It stated that, while it was not adopting a *per se* rule disapproving any settlement that did not follow the Code's priority rules, it was deeply concerned about the consequences of allowing parties to ignore those priorities:

> Rejection of a *per se* rule has an unfortunate side effect, however: a heightened risk that the parties to a settlement may engage in improper collusion. Thus, whether a particular settlement's distribution scheme complies

> with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is "fair and equitable" under Rule 9019. *The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code.*

Id. at 464 (emphasis added) .

The court went on to say, however, that "where the remaining factors weigh heavily in favor of approving a settlement, the bankruptcy court, in its discretion, could endorse a settlement *that does not comply in some minor respects with the priority rule* if the parties to the settlement and the reviewing court clearly articulate the reasons for a settlement that deviates from the priority rule." *Id.* at 464–65 (emphasis added). Thus, under the Second Circuit's view, the absolute priority rule is the "most important factor," and parties should not be allowed to use settlements as a means to avoid them.

By contrast, the Third Circuit's decision here approved a settlement that not only was concededly entered into as a means to avoid the priority strictures of the Code, but also completely eliminated all rights of one group of priority creditors. The settlement was thus not merely a minor compromise of those rights; it was a total destruction of them. It is not possible to reconcile the Fifth Circuit's total bar on such settlements and the very limited scope allowed by the Second Circuit with the Third Circuit's approval of this settlement as the "least bad alternative." Thus, there is a distinct split between the circuit courts on this important issue. This Court

should grant certiorari to resolve that split and provide needed guidance to the lower courts.

II. The Third Circuit's Decision Threatens to Undermine the Priorities Congress Established in the Bankruptcy Code, Many of Which Protect Important State Interests.

As noted *supra*, at 1–2, States have a variety of interests protected by the priorities set out in the Code. Those interests include States' sovereign right and ability to enforce a variety of laws. Of these interests, however, tax collection is perhaps of most importance to the States, and this Part therefore focuses specifically on the threat to States of settlements that undermine the tax-related priorities in the Code.

Paying taxes will rarely, if ever, be viewed by others in a bankruptcy as desirable or as benefitting the debtor's reorganization or ability to make payments to its other creditors in the way that paying rent or wages or utilities contributes to that goal. Nevertheless, debtors, like all other entities, are not exempt from the dues they owe to society in the form of taxes, which are the "lifeblood of government," *Bull v. U.S.*, 295 U.S. 247, 259 (1935). To enforce that obligation and to protect government interests, Congress created an intricate set of specific claim priorities, discharge exceptions, lien treatments, and plan payment requirements in the Code applicable only to taxes. *See* Sections 503(b)(1)(B) and 507(a)(1) and (8) (establishing priorities for taxes); Section 523(a)(1) (establishing dischargeability exceptions for taxes); Sections 362(b)(9)(D), 362(b)(18) and 724(b) (establishing special rules for tax liens); Sec-

tion 1129(a)(9)(C) (establishing standards for repayment of taxes in a plan).

Those tax-related provisions are predicated on the assumption that the Code had a limited number of ways a case could proceed and be resolved. In a Chapter 11 case, for instance, while the debtor has substantial freedom in structuring the treatment of classes of claims, Section 1129(a)(9)(C) provides a precise minimum treatment for tax claims under a plan, and, in return, tax claimants are not allowed to vote on the plan. *See* Section 1123(a)(1) (priority tax claims are not classified for plan confirmation purposes) and Section 1129(a)(7)–(8) (only impaired classes can vote). Thus, unlike general unsecured creditors, tax creditors cannot persuade a more senior creditor to accord them added consideration to obtain their votes, but they can demand the protection provided by the Code. If those provisions, however, are subject to being set aside as irrelevant when parties make plausible arguments that they have devised a better order of payment under the facts of a particular case, then there will soon be little left of the protections Congress enacted.

Indeed, a second recent decision by the Third Circuit in *In re ICL Holding Co.*, 802 F.3d 547 (3d Cir. 2015), allowed a buyer to resolve objections of general unsecured creditors to a credit bid by the secured lender for the purchase of all of the debtor's assets in a pre-confirmation sale, by paying them $3.5 million while, at the same time, providing nothing for the priority tax claim of the United States. While the analysis in *ICL* is not identical to the Third Circuit's analysis in this case, *ICL* is another case where, as in *AWECO*, parties filed bankruptcy

and then attempted to skip over taxes that would otherwise have to be paid.

And even in this case, the first choice of the settling parties was to eliminate payment not only to the employees, but also to the taxing authorities. While Sun was more concerned with the employees than the taxes, and the proposed settlement was changed after the taxing authorities objected, it is yet another example where parties in bankruptcy were willing to ignore the Code's prescribed treatment for taxes. This case thus underscores the importance for the States in having this issue resolved so that they can know whether the current Code is sufficient to protect the priority of their taxes or whether it must be changed to limit the degree to which parties can rewrite the Code provisions and create their own priorities.

This case is in many ways a counterpart to this Court's prior decision in *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008). There, the debtor argued that it was entitled to the exemption from transfer taxes on sales of estate assets under a confirmed plan as provided for in Section 1146(a), despite the fact that it had not yet confirmed (or even proposed) a plan. *Id.* at 36–37. While that case involved a relatively small tax (less than $40,000 on an $80 million sale), the debtor argued that the sale might be jeopardized if it had to pay those taxes, and that delaying the sale until a plan was confirmed, as the States asserted Section 1146(a) requires, would jeopardize its reorganization. *Id.* at 35, 49. This Court rejected that argument and required the debtor to follow the Code's provisions. *Id.* at 52–53.

Under the Third Circuit's analysis in this case, however, parties could incorporate such a pre-confirmation sale into a "settlement" of some sort, and then distribute the assets or sale proceeds to whomever they thought best. In such a settlement, moreover, they could arrange to avoid paying the much larger capital gains or sales taxes that might be applicable to such a transaction (as in *ICL*) so long they could articulate a scenario by which this would give *some* parties in the case more than they would otherwise get—what the Third Circuit called the "least bad alternative"—even if the favored parties were not those to whom the Code gives priority.

Furthermore, the approach approved by the Third Circuit could quickly become the norm. "Third party releases," for example, which were originally said to be appropriate only in "extraordinary circumstances," have now become commonplace. *See* Cert.Pet. at 28–29. Indeed, it is difficult to find a plan in a Chapter 11 case, large or small, that does not contain two to three pages of broad release language for non-debtors who have any connection at all to the case.

In sum, allowing courts to approve settlements that ignore the existing priority structure for claims whenever the parties can structure the scenario to make that the "least bad alternative," will ensure that disfavored creditors will be left out regardless of their priority under the law. In this case, the settlement provided funds to one group (the unsecured creditors), while eliminating or hampering litigation that would have benefitted other creditors. This Court should halt this practice before more disfa-

vored creditors, such as governments owed taxes or employees owed wages, are unfairly harmed in blatant disregard of the priority scheme of the Code.

CONCLUSION

For all the reasons set forth above, the Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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